

## TRANSCRIPT

### FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

December 5, 1980

#### Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

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Meeting of the Federal Open Market Committee

December 5, 1980

A meeting of the Federal Open Market Committee was held on Friday, December 5, 1980, at 2:10 p.m., at the call of Chairman Volcker. This was a telephone conference meeting, and each individual was in Washington, D. C., except as otherwise indicated in parentheses in the following list of those participating.

PRESENT: Mr. Volcker, Chairman  
Mr. Solomon, Vice Chairman (New York)  
Mr. Gramley  
Mr. Guffey (Kansas City)  
Mr. Morris (Boston)  
Mr. Partee  
Mr. Rice  
Mr. Roos (St. Louis)  
Mrs. Teeters  
Mr. Wallich  
Mr. Winn (Cleveland)

Messrs. Balles (San Francisco), Baughman (Dallas), Eastburn  
(Philadelphia), Mayo (Chicago), and Timlen (New York),  
Alternate Members of the Federal Open Market Committee

Mr. Corrigan (Minneapolis), President of the Federal Reserve  
Bank of Minneapolis

Mr. Altmann, Secretary  
Mr. Bernard, Assistant Secretary  
Mr. Oltman (New York), Deputy General Counsel  
Mr. Axilrod, Economist

Messrs. Balbach (St. Louis), J. Davis (Cleveland),  
R. Davis (New York), T. Davis (Kansas City),  
Eisenmenger (Boston), Ettin, Henry, Keir,  
Kichline, Truman, and Zeisel, Associate Economists

Mr. Pardee (New York), Manager for Foreign Operations,  
System Open Market Account

Mr. Sternlight (New York), Manager for Domestic  
Operations, System Open Market Account

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Mr. Coyne, Assistant to the Board of Governors  
Mr. Beck, Senior Economist, Banking Section, Division of  
Research and Statistics, Board of Governors

Messrs. Boehne (Philadelphia), Burns (Dallas), Fousek  
(New York), Keran (San Francisco), and Scheld,  
Senior Vice Presidents, Federal Reserve Banks of  
Philadelphia, Dallas, New York, San Francisco, and  
Chicago, respectively

Mr. Meek (New York), Monetary Adviser, Federal Reserve  
Bank of New York

Mrs. Nichols (Chicago), Vice President, Federal Reserve  
Bank of Chicago

Mr. Campbell (New York), Assistant Secretary, Federal  
Reserve Bank of New York

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CHAIRMAN VOLCKER. We're sending out a search party for Governor Schultz. I don't know whether he is back in Florida or not. I just wanted to [bring] you all up to date on the markets and have a little group-think about where we are at the moment and whether we want to do anything or not. I will make a suggestion on that after we finish with the description that Mr. Axilrod will give you.

MR. AXILROD. Mr. Chairman, on the latest data the aggregates have been showing some signs of weakness, even on an overnight basis since late yesterday. As of the moment we're planning to publish this afternoon an increase of \$1.1 billion for M-1A and of \$1.2 billion for M-1B for the week of November 26, in each case less than the preliminary numbers had indicated. Preliminary numbers for the week of [December] 3rd show a drop--more than we had expected as of late yesterday--of about \$1.8 billion for M-1A and about \$1.7 billion for M-1B. These numbers would give us estimates for November of a 6.8 percent rate of growth for M-1A and a 9.6 percent rate of growth for M-1B. M2 remains strong, growing at a 12.2 percent annual rate, as the weakness in the transactions components of M2 has been offset by strength in the nontransactions components. We still expect growth in December, despite the very weak number for the 3rd, at rates of 3.7 and 4.9 percent for M-1A and M-1B [respectively]. The weaker recent numbers do, however, lower required reserves in this 5-week operating period. And given the level of borrowings that we had achieved in [the weeks of] November 26 and December 3, working through the paths for total and nonborrowed reserves hitting the targets would imply a level of borrowing for the current week and the next two weeks of around \$1760 million. So that's down somewhat from the \$2.1 billion level of borrowings that we actually had in the week of December 3rd. Borrowing on Thursday, by the way, was \$1.4 billion. So we are starting off not too far away from these targets but on the low side of them. I believe, Mr. Chairman, that updates the Committee on the position of the aggregates.

CHAIRMAN VOLCKER. Peter, do you want to fill us in on the market?

MR. STERNLIGHT. As for the market reaction today, we started out with a quite firm money market, Mr. Chairman. Funds opened briefly at 19-3/4 percent, went up to 20 percent, and even touched 21 percent briefly this morning. They slipped back to about 20 and then were 20-1/4 percent around 11 a.m. At that point we went in because, having drawn up these reserve paths as Steve described, we had a need for reserves in this week. We put in some repurchase agreement funds over the weekend. We had some difference between the Board staff's estimate and the New York staff's estimate, with New York seeing a larger need. The amount [of repurchase agreements] that we did fully met--in fact slightly more than met--the New York staff's estimate, and we did that amount because funds were trading at 20-1/4 percent then. I thought we were just experiencing a burst and a kind of psychological lifting of the funds rate. Following those repurchase agreements, the funds rate inched down to 20 and then to 19-3/4 percent. And then around 1:30 p.m. or so, the rate dropped off rather sharply, and to me rather surprisingly, to 18 percent. It looked as though the big buyers had their demands satisfied and they were seeing

some supply from agencies, banks, and regional banks around the country.

I don't know if you want me to go into this, but I had given an estimate at the time of our usual morning conference call that, given this level of borrowing of around \$1-3/4 billion, I would have expected the funds rate to back [down] from the 20 percent plus level to perhaps 19 to 20 percent. That would still be my feeling. I remain somewhat puzzled as to the latest drift off to the 18 percent area. As for the market reaction elsewhere to the discount rate [increase], there was an initial very modest decline in the Treasury market, with [a move in] the long end of the market of around 1/2 point and most of that has been recovered now. So there's about no change on the day in the longer end of the market. The shorter coupon had been off as much as 3/4 point, but has recovered some so those [issues] are only off about 1/2 point. The greatest remaining change is in the bill area, particularly the short-term bills; the 3-month bill is up almost a full percentage point to about 15.80 percent. Finally, CDs seem to be up about 1/2 percentage point; the 3-month CD is around 18.40 percent and up. And the prime rate, I should mention, is pretty generally becoming 19 percent now, [led] off by Citibank.

CHAIRMAN VOLCKER. Just for the purpose of completeness: You have had a little action in the international area, Mr. Pardee, I take it?

MR. PARDEE. Yes, we have. The dollar has continued to be up a bit since the last FOMC meeting. It has advanced by about 2-1/2 percent against the Deutschmark and by similar amounts against other currencies. We have continued to buy marks in a large amount. All of that to this point has been [unintelligible] to the Treasury. The Treasury now, however, on the day's business is covered as far as the Carter notes are concerned. The presumption is that we will now [revert] to even sharing [of purchases] between the Federal Reserve and the Treasury; [we have bought] \$400 million worth of [marks] out of the \$1.5 billion authorization to buy marks. The factors relating directly to the [strength of the] dollar are mainly due to rising interest rates in the United States. And in Europe we have a situation in Poland which has led to a number of [unintelligible] in the market [unintelligible] selling of the Deutschmark [and going] into dollars.

CHAIRMAN VOLCKER. Well, I don't think we have to make any decisions on [the international side] today, but I think we have to review the domestic situation, to put it in a setting of the Committee's decision on the directive. [At] the meeting, we made a decision which [implied] a certain reserve path and we also made a borrowing decision of \$1-1/2 billion, as I recall. I think the understanding was that if the actual money supply figures came in somewhat higher than that, but not too much higher--then that would, of course, be reflected in higher borrowing from the natural consequences of the nonborrowed path in the short run. And if [the borrowings] came in high enough, we would have to make an adjustment in the nonborrowed reserve path. As has happened after other recent meetings, they did indeed come in high, and they came in high enough so that we did make an adjustment in the nonborrowed reserve path as well as having the natural consequence of the higher money supply figures. And we are left, I guess not certainly, but with the

probability that the 2-month numbers will look higher. On the present estimates that Steve gave you they're certainly higher than the Committee's decision. But there is a certain smell about this situation at the moment of the money supply perhaps coming under control. I say that not so much because I am so impressed by the most recent figure of a projected decline next week, but largely because of the way the figures have been coming in. For the first time this fall we have been getting downward revisions instead of upward revisions. I don't know why we have always had upward revisions before and I don't know why there is a change now. But it has a slight smell to it--I hope more than a slight smell--that we may be getting some stability here. So there is a chance that we have in that sense done enough. But in terms of the Committee decision we made at the meeting--I forget, has it been modified since the meeting?

MR. ALTMANN. Yes.

CHAIRMAN VOLCKER. Yes, it was modified once since the meeting. So we have that 18 percent limit [on the funds rate] in any event. And at the moment that is in jeopardy. Clearly, the Desk doesn't have much maneuvering room--or any maneuvering room if that [limit were viewed] literally. What I would suggest in this somewhat uncertain situation is that we in effect temporize for the moment and not make a decision to change that limit. We might have to do that, or at least review it, next week. But for the moment I would propose that the Desk be extended an understanding that, in the immediate wake of the discount rate change, it has whatever maneuvering room it feels is necessary to keep on the path--with the hope that that will not mean a much higher federal funds rate than where it has been, certainly not higher than the 20 percent area. But I can't guarantee anything. Then we will see, looking a week from now when we will have another week's preliminary figures on the money supply, whether it is really desirable and necessary or not to operate within that constraint of the 18 percent limit.

Now, the figure that Steve gave you is a projection for December. If I recall correctly, it assumes a pretty big increase in the money supply in the week of the 10th. We have no data on that whatsoever. That's just a reflection of the belief that every other month recently has had a big increase in the money supply at the beginning of the month and that a cautious projection better assume that. But we really have no specific information on it. And if we're really getting a turn in things here, maybe that figure will not come in so high, and then the December estimate would look quite different. I obviously don't know that now, but that is a factor in my mind in suggesting that we not make a permanent type of change in the upper limit. It's not very permanent anyway in that we're meeting fairly soon. But an explicit change in the upper limit may not prove to be necessary or desirable in the light of what we will know by the middle of next week. Meanwhile, the Desk needs some operating room and we could have a note to that effect in the published record that comes out after the next meeting. That is, in the wake of the discount rate change the Committee had a consultation about the immediate consequences in the money market and agreed that during the period of immediate reaction the Desk should have sufficient operating leeway to conduct its operations without being constrained by the 18 percent rate, pending further consultation. The implication is that we will come down to the 18 percent limit in the latter part of next week if

we do not by that time make an explicit decision to change [the limit]. I haven't gotten precise here, but that is the substance of what seems to me appropriate at the moment.

I might just add one further thought. If the money supply figure came in very low for the weeks that we don't know anything about, we've got to decide whether to drop [the borrowing path] instead of the very decided increase [we were] talking about. It just raises the normal question of whether that adjustment in the nonborrowed reserve path that was made when it was high shouldn't be reversed so that that's washed out, which would itself relieve pressures on the market. But that's just a hypothesis based upon something we don't know.

VICE CHAIRMAN SOLOMON. Paul, do you want comments?

CHAIRMAN VOLCKER. Yes.

VICE CHAIRMAN SOLOMON. Okay. I think this is a reasonable proposal as long as it's going to be in the record. Otherwise the New York Fed would be in danger of being [on the hot seat] for a greater period of time.

CHAIRMAN VOLCKER. No, I agree. I think it has to be in the record.

VICE CHAIRMAN SOLOMON. Sure, and we can see what the situation is next week.

MR. ROOS. This is Larry Roos. I have two questions and I direct these toward Steve. First, what would the December M-1B figure [have] to be [assuming] a 9.6 percent growth of M-1B in November to get us to the top of our annual range? Do you know approximately?

MR. AXILROD. No, I couldn't answer that right now, Larry. I can give you a figure that [might give you some perspective]: To be perfectly consistent with the target path adopted at the previous Committee meeting, it would have to be minus 6.1. But the--

MR. PARTEE. That's above, I think.

MR. AXILROD. And that target path led you to a rate above the long-run range.

CHAIRMAN VOLCKER. It would take a huge decrease to hit the annual figure, Larry.

MR. STERNLIGHT. [Unintelligible.]

MR. PARTEE. We could close a few banks.

MR. ROOS. Paul, do you [want to] talk about the [public] relations [aspects] of an overshoot of those annual targets? In other words, it seems to me that the issue of what we do in the next few weeks really [involves] the alternatives of the fed funds rate rising, perhaps significantly, or the [money growth] overshoot occurring [unintelligible].

CHAIRMAN VOLCKER. Well, I think we have lost on the annual target on M-1B explicitly, Larry. M-1B is almost certainly going to be over [its annual target]. Of course, that target technically is a little low but even if we adjusted it, we would almost certainly be over it. But if we talk about the theoretical possibility of having a big enough decline in M-1B in December to be within the range, I think we would get a helluva lot of flak from the other direction for having such a big decline in the number in one month. I don't know what the rate would have to be [in order to come within our target range], but my impression is that it must be a 10 percent annual rate of decline or something like that.

MR. AXILROD. To hit the cone, so to speak, in December would involve a lesser decline, but it would be huge. And to hit the quarterly average that would [produce] a fourth quarter-over-fourth quarter number at the upper end of the range would involve a massive decline as well.

CHAIRMAN VOLCKER. I don't know. We are 1 percent above it with two-thirds of the quarter gone. Somebody's doing the arithmetic here, but--

SPEAKER(?). To get to the top of the cone we'd have to have a decline at about a 7 percent annual rate.

MR. MORRIS. Paul, this is Frank Morris.

CHAIRMAN VOLCKER. Let's finish this point. I am just getting some numbers and I can relay them to you.

SPEAKER(?). Okay, the top of the cone would be \$411.6 billion.

CHAIRMAN VOLCKER. Right.

SPEAKER(?). And we're at \$414-1/4 billion for M-1B. So we would have to have a 7 percent annual rate of decline to reach the top of that cone.

CHAIRMAN VOLCKER. Right. But you haven't figured out the quarterly figures?

SPEAKER(?). No.

CHAIRMAN VOLCKER. Well, I can't give you the full answer. But to hit the top of the cone in December, just looking at it monthly not quarterly, takes a 7 percent decline. And it must take three times that, I suppose, to hit it for the quarterly figures. So I think for the quarterly figure we're talking about a change that is out of sight. But even if [we got that], it would be a decline like the one we had in April. And everybody would say, my God!

SPEAKER(?). Some people may say more than that.

CHAIRMAN VOLCKER. Maybe it will happen. Who knows!

MR. MORRIS. Paul, this is Frank Morris. Isn't this a bit academic? Given the lags, there isn't much we can do on December 5 to



impact the money supply in December. But I would add that I think your "smell of things" is also supported by [the economic] statistics, particularly the evidence of a decline in housing and reports of a very sharp [slowing in] retail sales in November. So I support your feeling.

CHAIRMAN VOLCKER. Larry, I don't know whether you had finished.

MR. ROOS. Yes, I have finished; that answers [my question].

CHAIRMAN VOLCKER. But do you have an opinion on the proposal?

MR. ROOS. On the proposal, I am fully in agreement with you.

CHAIRMAN VOLCKER. Okay.

MR. CORRIGAN. This is Jerry Corrigan. I, too, am in agreement with the proposal.

CHAIRMAN VOLCKER. Okay.

MR. MAYO. It sounds fine to Mayo.

CHAIRMAN VOLCKER. Okay.

MR. WINN. Paul, this is Willis. I haven't any objection to the statement of the principle. I would feel a little more comfortable if we [lifted] the federal funds range and told the Desk not to go above 18 or 19 percent, except temporarily.

CHAIRMAN VOLCKER. Well, the proposal is that we leave it at 18 percent but tell the Desk it can be above that temporarily pending further discussion next week.

MR. BALLEs. Paul, this is John Balles. I would just like to be [a devil's advocate] for one minute. It's not clear to me what we gain by [this] course. [Why not] increase the upper limit instead of just telling the Desk it is permitted to exceed it for a week? Is it substantive or procedural or are there public relations aspects to this in terms of the public record later on or what? I don't quite understand this.

CHAIRMAN VOLCKER. Well, there's nothing particularly [in the realm of] public relations about it. My feeling is that the Desk needs a little maneuvering room. But I suspect, looking at it over a time horizon and given the uncertainty in the money supply, that it is a question of whether people want to make a decision now that the federal funds rate should be at any particular point. I don't know whether explicitly for the next day or two, 19 percent gives the Desk the maneuvering room. On the other hand, I am not crazy right at the moment myself about making a decision that the 18 percent limit should be raised until I see at least the following week's money supply data, given my sense that the trend may be changing here. That may be wrong and we may well have to raise the rate. But I don't know precisely how much maneuvering room the Desk needs at the moment. I hope it is

not too much, but I don't want to have the Desk unduly inhibited either.

MS. TEETERS. Is there a chance it will go to 19 percent and just stick there? If we get--

CHAIRMAN VOLCKER. Governor Teeters just came in. Let me just catch her up to date. The latest information is that the federal funds rate at the moment is at 18 percent, but it had been over 20 percent earlier in the day. So I don't know. It is not at 19 percent at the moment anyway.

MR. PARTEE. This is Chuck Partee. Paul, one question I would have is about the way you put it. You put it rather strictly that the Manager would go about his reserve-supplying activities along the path and see what was needed. That to me almost means that there is no cap at all on the funds rate for this next week. And since I have a sense of the market being in a crisis atmosphere, I have a little concern about the possibility that, in fact, the rate might go very high in this next week.

CHAIRMAN VOLCKER. Well, I would be concerned if I thought it was going very high. I am a little less concerned [given] the most recent trend--that [the market] is [not] fixing a 20 percent rate in its mind. What I meant to imply is that the Manager knows the general limit is still 18 percent. And while that is being suspended, he is [to be] within the limits of what is feasible on the path. He is [to be] a bit tender with the market this week, if that answers your question.

MS. TEETERS. I have a question. If he sticks to the path, will we be in a position of providing reserves this coming week or withdrawing them, Steve?

MR. AXILROD. Well, we have differences in estimates, as Peter reported earlier. We have to provide reserves. What Peter has done today already provides more than our path had called for, assuming that the estimates are accurate. So we are in a position where we have already provided more than the amount called for and unless there is a shortfall in the factors, we wouldn't be providing more. And in response [to what we provided today] the funds rate did drop down to 18 percent.

MS. TEETERS. I mean next week. Are we going to be in a position [to add reserves] or have we done all we're going to do [as of] today?

MR. AXILROD. It depends. If the factors break away from us on Monday or Tuesday, then we might have to provide more.

CHAIRMAN VOLCKER. At the moment it looks as if we have done all we have to do.

MR. AXILROD. The implied level of borrowing, Governor Teeters, dropped to \$1760 million from the \$2 billion we had then. So we are providing [reserves] on that assumption.

MR. STERNLIGHT. Could I [chime] in on something? I think Steve is referring to the current statement week. Governor Teeters, if you are asking about the following statement week, I believe we would have to provide reserves then.

MS. TEETERS. Thank you, Peter.

CHAIRMAN VOLCKER. I don't know where [we were]. You raised a question of clarification, Governor Partee. Do you have anything further to add?

MR. PARTEE. I guess I share your feeling that the aggregates are in the process of coming under control. Indeed, I think we are now in the range where the great danger is that we will overshoot quite a bit. Therefore, since I think the process is already under way of giving us the numbers we want, I would like to avoid any sense of true crisis in the market. So, I will buy your proposal, but I would buy it with the reservation that we don't mean by it that we would let the rate just escalate in these next few days to anything it wished to do.

CHAIRMAN VOLCKER. No, I didn't mean to imply that in the context of where we are. But I'd hate to say 19 percent is just the right number.

MR. PARTEE. No, I agree. I think there may be a very real chance that we can keep it within the 18 percent limit after a couple of days--[it seems to be] settling down--but I am not sure of it.

MR. EASTBURN. Paul, this is Dave Eastburn. I think the more crucial part of the Desk's problem will be how rapidly [to respond] as the aggregates come in low, as I suspect they will. I would be inclined to agree with what you said earlier, that we should respond fairly rapidly and promptly to low aggregates figures if and when they do develop.

VICE CHAIRMAN SOLOMON. What does that mean, Dave? If you mean by [unintelligible] reserves?

MR. EASTBURN. I think we ought to let the rates come down [if] the aggregates come in low. Does that answer your question?

MR. PARTEE. But we do have a range, Dave, with the bottom being what--14 percent?

CHAIRMAN VOLCKER. Yes. I think we probably won't have to face that question until the next Committee meeting at the earliest. I think we are really talking about the degree of leeway we have on the up side during what we hope is a period of transition here. It's hard to believe that those numbers would come in so low in the next two weeks that--. You know, the optimist would say that under those conditions the federal funds rate would settle in the 17 to 18 percent area. I don't think we are talking about anything lower than that in this time period. And one has to be optimistic even on that score, but that's what we will know next week.

VICE CHAIRMAN SOLOMON. I assume that we would accept the period of undershooting, if we get to that point, for sufficiently

long that we correct some of the overshooting that we had in the second half of this year.

CHAIRMAN VOLCKER. That is what the current directive says.

MR. EASTBURN. I guess what I was [saying], Tony, is that I would agree with Chuck in that I think we are in great danger of overkill here. I believe the market is very sensitive to the level of interest rates, and to the extent that we can permit some easing when we see the way clear to do so, I think we ought do it as promptly as possible.

VICE CHAIRMAN SOLOMON. I agree.

MR. GUFFEY. Mr. Chairman, Roger Guffey. I would support your proposal if I understand it, and I think I do. I would add just one other point. It's puzzling to me, in view of the discussion here and at least our view as to what is happening, why the discount rate was increased yesterday. It would be helpful to me if somebody could explain the rationale for it.

CHAIRMAN VOLCKER. Well, I will explain it to you as best I can. I think it is rather interesting that perhaps for the first time in some time we seem to have a real split in evaluations of the Reserve Banks [regarding the appropriate level for the discount rate.] Some of them felt pretty strongly that it should not be moved and others felt very strongly that it should be moved. Some of that flavor was reflected in our own discussions, and I think it's inherent in the kind of situation we are in. It was a question of balancing the risks of overkill, as it's sometimes put, against the risks of underkill, as it is also sometimes put. In favor of doing it was the fact that the aggregates as of the moment are still running high and that this sense of things perhaps turning may or may not be real. Even if it is real, the fact of the moment is that now the aggregates are high and if they continue high, those problems of credibility and so forth that you people keep telling me about are there. We are at a very sensitive stage in terms of what has happened in the past in terms of credibility and the current inflation problem and all the rest. So that was balanced against the risk of either appearing to contribute too harshly to a business downturn or even the possibility, which begins to glimmer in one's eyes, that the money supply might actually go down--and that it might actually go down faster than one wants to see it go down. That case is far from proven, but those are the two balancing factors. And I suppose the decision reflected the fact that there was a feeling that there was a greater risk of [overshoot] rather than [undershoot].

MR. GUFFEY(?). I guess I am really asking what was the chance of--

MR. PARTEE. Greater damage. [Unintelligible] as a result of it, whether or not it was merely an announcement effect that offset some of these concerns, or whether or not the realization was that unless other action was taken we would, indeed, increase the interest rate levels.

CHAIRMAN VOLCKER. Well, and I speak for myself, we weren't looking for any great announcement effect. And if the money supply is

turning--but that's an if--there's a hope that there wouldn't be all that much interest rate effect. If the money supply is not [turning] for that or any other reason, we would get an interest rate effect. But if the money supply really turns, maybe the interest rate effect won't amount to much because we can relieve the borrowing pressure. That is precisely the reason I put this decision today the way I did, as "in the wake of the immediate impact" [of the discount rate increase]. I don't want to prejudge that issue. And we do have this immediate market reaction type of thing. We will give it a week to see whether it settles down; that is what I am saying.

MR. GUFFEY(?). In that context, I would support the proposal.

MR. WALLICH. Mr. Chairman, it seems to me that we took one type of action yesterday, which was an effort to be consistent. We shouldn't back away from taking further action that would be consistent--that is, to raise the upper limit. Now, [if] it's true that the aggregates are slowing and may be coming down, then there isn't going to be any effect. On the other hand, if they are as relentless and they continue to go up, we wouldn't have lost several days' time in making that move. [I'd prefer that] we go up. I presume we will have to make that move anyway.

CHAIRMAN VOLCKER. Yes, but [we are not] preventing it from going up at the moment, although the market is being treated cautiously. That's--

MR. WALLICH. It seems to me it is a logical and consistent action to have a discount rate increase and then to follow that up with an increase in the funds rate range.

MS. TEETERS. And then you will argue for an increase in the discount rate again to close the gap.

MR. PARTEE. It's going to catch up.

MR. WALLICH. The gap closes gradually; it doesn't close all at once. But it certainly diminishes. We took a large step yesterday; I don't see why we should back away from a small and possibly quite inconsequential step now.

CHAIRMAN VOLCKER. Well, I don't know what steps you are proposing, because I don't know where the rate may fluctuate in the next few days. All I am saying is the kind of consideration that you are raising seems to me one that would appropriately be considered in the middle of next week when we see whether it is necessary or whether it isn't.

MR. WALLICH. Well, it certainly [would] be appropriate next week. I would much rather take it now.

VICE CHAIRMAN SOLOMON. In answer to Henry, I think the chief advantage of your approach, Paul, is that we don't know now whether to raise it to 19 or 19-1/2 or 20 or even 21 percent for that matter. This may be a very involved situation, and I think there is a chance that it will settle down in the course of the week. If we were to move [up] and raise it to 19 percent, we might have to meet again

Tuesday or Wednesday to raise it to 20 percent. So, there is some advantage in this approach, even though normally I don't think it is a good way of addressing a problem.

MR. WALLICH. Is it your thought that by letting it remain undefined, that it might actually go higher than it would go if we set a limit of, say, 19 percent?

CHAIRMAN VOLCKER. Well, if we set a limit of 19 percent, presumably [Peter] is going to go out there and defend 19 percent fairly precisely at the moment and I am not sure that is a good thing.

MR. WALLICH. But [not] on a daily basis, a weekly basis.

CHAIRMAN VOLCKER. That's right. But [if] it is already at 20 percent over the weekend, I don't know whether [a limit of] 19 percent means that he would have to go down to 18 percent after the weekend if we adopted a strict construction--

MR. BAUGHMAN. This is Baughman. It seems to me that I am sitting here listening to arguments for taking [the limit] off.

CHAIRMAN VOLCKER. You have. The proposal is to take it off with a caveat that it is treated tenderly for one week.

MR. BAUGHMAN. The proposal is acceptable to me.

CHAIRMAN VOLCKER. Who haven't we heard from?

MR. GRAMLEY. This is Lyle Gramley. I have said nothing yet, and I am with you. I think it's a good way to handle the problem now.

CHAIRMAN VOLCKER. Governor Rice has not said--

MR. RICE. I support you, Paul.

CHAIRMAN VOLCKER. Has anybody not been heard from?

MS. TEETERS. Me.

CHAIRMAN VOLCKER. Governor Teeters has not been heard from [except] in asking a question.

MS. TEETERS. I voted against the discount rate increase yesterday. I just think we are using this process to [ratchet] up the rates now to where they should be or where they can be. Mainly for consistency, I can't support this proposal because I think if it goes wrong, you folks are going to come back and ask for a discount rate increase again. And I think that is going too far. I can see the advantage of letting it fluctuate for a week, but the experience that we had last spring was that every time we added another percentage point on the range, we went to the top of it and almost instantaneously it stuck there. And then another week went by and we had to raise it again. I would just like to see the ratchet stopped. So, I will be consistent and vote the same way I did on the discount rate.

CHAIRMAN VOLCKER. You mentioned a vote. I'm now talking to the Secretary. There seems to be a consensus; do we also need a vote? I think this has to be in the record. For general matters of explanation it should be in the record, but also for the reason Tony mentioned. We can have a vote. We can either have it now or we can try to write this down in a sentence or two and send it around in a telegram for a vote. I can try to phrase it now and we might as well have a vote. But let me see what the Secretary says about this.

MR. ALTMANN. Well, if there is an objection to this procedure, there really is no way to register a dissent apart from having a vote on the issue of whether to maintain the current directive or modify it in some way, which either raises the limit or provides for a temporary exception.

MR. PARTEE. I think we need to have a vote, Murray, because we had a vote on raising the limit a week ago or whenever it was. So to accept [exceeding] that limit, since that limit was established by vote, I think does require a vote.

CHAIRMAN VOLCKER. I have no problem with having a vote; it may be appropriate. Let me just try to formulate something orally to see whether it comes close enough to capture the spirit of this so we can have the vote now instead of waiting for a telegram vote. I would propose, in the light of the uncertainties surrounding the immediate reaction to the discount rate change and the questions as to market reaction in the ensuing days, that the open market Desk be given latitude to pursue a reserve target without its operations being confined by the existing 18 percent limitation [on the funds rate] in the directive, pending further consultation if necessary--if in fact the rate is exceeded in the middle of next week.

MS. TEETERS. How long is that to hold? Is it the next calendar week or until the middle of next week?

CHAIRMAN VOLCKER. Don't pin me down on whether the [consultation] is Wednesday or Thursday. What I have in mind is that I'd like to get a look at which direction the money supply is going in and we won't know that until the middle of next week some time.

MR. PARTEE. Probably Thursday.

CHAIRMAN VOLCKER. Probably Thursday is what we are talking about. So basically this is carrying us through this statement week.

MR. WALLICH. Mr. Chairman, just to clarify my position: I don't think it makes a great deal of difference in terms of the rates likely to be achieved. The time period is very short, to be sure. But it does seem to me that one of our problems has been a lack of firm consistency on [timing]. And that is what we could demonstrate here. We made one move; we make another move. It is not a very risky or damaging move and I think it would enhance our posture.

CHAIRMAN VOLCKER. I am not quite sure I understand that. If you went all the way and said we should permanently take off the limit, then I think you would be making a real postural change. I'm not sure what the postural implications are to go to 19 percent, say, if that turns out to be constraining this week.

MR. WALLICH. Well, it means that we take a move that is logically consistent with the previous move. And what we sought to [accomplish] would be missing in the record if we don't take it.

MR. PARTEE. I think you would need 20 percent, Henry.

MR. WALLICH. Even that aggressive?

MR. PARTEE. I mean to be logically consistent.

MR. WALLICH. When we moved only one percentage point [on the discount rate]?

MS. TEETERS. To be logically consistent, Henry, I would take the floor off also.

CHAIRMAN VOLCKER. I think we are probably ready to vote if I have sufficiently or adequately conveyed [the sense] of the sentence that would appear in the Committee's record. Mr. Altmann, do you want to call the roll?

MR. ALTMANN.	
Chairman Volcker	Yes
Vice Chairman Solomon	Yes
Governor Gramley	Yes
President Guffey	Yes
President Morris	Yes
Governor Partee	Yes
Governor Rice	Yes
President Roos	Yes
President Solomon	Yes
Governor Teeters	No
Governor Wallich	No
President Winn	Yes

SPEAKER(?). Gee, we like these ballots don't we?

CHAIRMAN VOLCKER. I will be interested to see how the dissents read.

MR. ROOS. Paul, this is Larry and I have a question.

CHAIRMAN VOLCKER. Yes.

MR. ROOS. You indicated that at our next FOMC meeting we're going to have a preliminary discussion of the 1981 ranges.

CHAIRMAN VOLCKER. Yes.

MR. ROOS. Shall we be prepared to discuss that in some depth, or what are you planning to do on that?

CHAIRMAN VOLCKER. Well, I don't know quite what you mean by "some depth." I would anticipate a fairly considerable discussion that would extend over some period of time. I think the discussion can be a little wider--more free ranging--at this stage than it probably can be at the [following] meeting when we are going to bore into a very specific decision. So if anybody has radical thoughts,



you certainly ought to bring them up at that meeting and we can let our minds roam a bit and have a kind of philosophical debate. I think there are real questions here. We face the problem next year--and I just don't know what we should do about it--regarding the meaningfulness of the M-1A and M-1B targets. Abstracting from that, I have a few ideas of my own on presentation that I am looking at; it's purely presentational, but it is interesting. I am sure that no presentation can solve the problem of judging the uncertainty about M-1A and M-1B and their meaningfulness.

In that connection, I might say that the banks have gotten quite excited about this decision of the DIDC--for the same reason that we didn't like it much--to have the same rate on transactions balances as on savings deposits for commercial banks. They have visions dancing around in their heads that all their savings deposits are going to turn into NOW accounts. And they don't like it because it will cost them a 12 percent reserve requirement. But apart from that, it certainly is going to make those M-1B figures look funny. We may have to have a target of 32 percent for M-1B next year!

MR. MORRIS. This is Frank Morris. I suggest that we don't have a target for the M-1s because we don't have any basis for making projections.

CHAIRMAN VOLCKER. Well, that is one of the things I think we ought to be looking at at this next meeting. Do we end up with the conclusion, whether we like it or not--maybe some people like it anyway--that we have to put more weight on M2 and M3? I don't know; it is a very difficult subject.

MR. PARTEE. M-1B plus savings accounts.

CHAIRMAN VOLCKER. Governor Partee was just saying maybe we have to follow an M-1B plus savings accounts kind of figure. But the trouble with that is that savings accounts have been going down so precipitously that--

MR. PARTEE. So we put a [unintelligible] for that.

CHAIRMAN VOLCKER. I haven't got an answer, but we ought to be thinking about it before the next meeting. Any other questions or comments? I guess the answer to your question, Larry, is that I would use the term "in depth" [to describe the nature of our discussion next time]. I would not assume, obviously, that we have to zero in on the exact [growth rate] percentage of a target. But we ought to try in a preliminary way to clear out as much of this underbrush, if that is what it is, as we can, so we have the issues clearly in our minds and have some possible approaches for dealing with them.

MR. ROOS. Fine.

CHAIRMAN VOLCKER. Okay, that's it if nobody else has any questions or comments. Thank you.

END OF SESSION